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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 226

GENERAL PUBLIC UTILITIES CORPORATION, as common parent corporation of an affiliated group of corporations, et al.,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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July 25, 1958

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No.

GENERAL PUBLIC UTILITIES CORPORATION, as common parent corporation of an affiliated group of corporations, et al.,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioners, General Public Utilities Corporation and all the corporations, members of an affiliated group of corporations, respectfully pray that a Writ of Certiorari be issued to review the order and judgment of the United States Court of Claims dismissing their petition to that Court.

Opinion Below

The Court of Claims wrote no opinion in petitioners' case. Its order, which appears in Appendix A attached hereto, at p. 17 *infra*, states that it is based upon its decision in *Atlantic City Electric Company* v. *United States*, decided the same day. The opinion of the Court of Claims in *Atlantic City Electric Company* v. *United States* (MADDEN, *J.*) is reported at 161 Fed. Supp. 811 and appears in Appendix A, at pp. 18 to 28, *infra*.

Jurisdiction

The order and judgment of the Court of Claims dated May 7, 1958 was entered on May 7, 1958 (see p. 17, *infra*). The jurisdiction of this Court is invoked under Section 1255(1) of Title 28 of the United States Code.

Question Presented

Whether the amount distributed from its earnings or profits by a public utility corporation in redemption of its preferred stock, such amount being the excess of the total amount distributed over the net sum originally received by it for such stock, constitutes a "dividend" for which the corporation is entitled to the "dividends paid" credit provided under Section 26(h) of the Internal Revenue Code of 1939, as amended.

Statutes Involved

The applicable Statutes and Regulations appear in Appendix B, attached hereto, at pp. 29 to 35, *infra*.

Statement

This is a suit for refund of Federal income taxes, brought in the United States Court of Claims (See 28 U.S.C. Sec. 1491). General Public Utilities Corporation (hereinafter called "GPU") was, during the calendar year 1947, the common parent corporation of an affiliated group of corporations as defined in Section 141 of the Internal Revenue Code of 1939 (26 U.S.C. 1952 Ed. Sec. 141), and for that year a consolidated Federal income tax return was filed on behalf of the affiliated group (S. Pars. 3 and 4)*. New York

* All the facts in the action were stipulated in the Court of Claims. References are to the numbered paragraphs of the Stipulation, a copy of which (without accompanying exhibits) was printed for the use of that Court and is attached hereto as Appendix C at pp. 36 to 41 *infra*.

State Electric and Gas Corporation (hereinafter called "New York State") is a public utility within the meaning of that term in Section 26(h) of the Internal Revenue Code of 1939, as amended, (S. Par. 19) and during the calendar year 1947, was a subsidiary of GPU and a member of the affiliated group.

On or about July 8, 1941, New York State had issued and sold 120,000 shares of its 5.10% cumulative preferred stock of a par value of $100 per share, redeemable at $105 per share, for a price of $100.85 per share or an aggregate of $12,102,000 (S. Par. 10). In connection with the issuance and sale of that stock, New York State had incurred expenses in the amount of $47,753.99 (S. Par. 11). It recorded the transaction on its books by crediting $12,102,000 to capital and charging capital with the $47,753.99 of expenses (S. Par. 20).

On or about March 13, 1947, New York State redeemed its 5.10% cumulative preferred stock and paid to its stockholders therefor the redemption price of $105 per share, plus accrued dividends from March 1, 1947 to the date of redemption, or an aggregate of $12,620,400, of which $600,000 was attributable to the redemption premium and $20,400 to dividends accrued since the last dividend date (S. Pars. 14 and 16). In redeeming its 5.10% cumulative preferred stock, New York State thus paid out to its stockholders (in addition to the dividends accrued for 13 days prior to redemption) $498,000 more than the price at which it had sold that stock on original issuance; and if account is taken of the $41,192.07 in issuance and sales expenses for which no deduction was ever claimed or allowed in computing New York State's Federal income tax liability, the amount which New York State paid to redeem its preferred stock exceeded the net amount it had received therefor by $539,192.07 (S. Par. 18).*

* The net amount of such excess, $539,192.07, is sometimes referred to hereafter as the "redemption premium".

At the end of the calendar year 1947, New York State had earnings and profits, after taking into account all items affecting earnings and profits for such year other than the redemption of its 5.10% cumulative preferred stock, of not less than $1,000,000 (S. Par. 17). The excess amount paid in redemption of its 5.10% cumulative preferred stock was, in fact, charged to earned surplus on New York State's books (S. Pars. 13 and 20 and Exhibit J).

The affiliated group claimed a credit of $539,192.07 against surtax net income, as provided by Section 15(a) of the Internal Revenue Code of 1939, as amended, (26 U.S.C. 1952 Ed. Sec. 15(a)) in determining its consolidated surtax net income for the calendar year 1947 (S. Par. 8). This claim was based upon New York State's asserted right to a dividends-paid credit under Section 26(h), by reason of the payment of the redemption premium on its 5.10% cumulative preferred stock (S. Par. 6). The Commissioner declined to allow the claim, and a tax was assessed, which was based upon a computation of the affiliated group's consolidated surtax net income with no credit allowed for the redemption premium (S. Pars. 5, 6 and 7). Taxpayers paid the tax (S. Par. 7) and filed a timely refund claim (S. Par. 8) which was disallowed, (S. Par. 9), and this action was duly commenced in the Court of Claims.

The Court of Claims dismissed the action on the ground that the redemption premiums did not constitute "dividends" for which petitioners were entitled to a dividends paid credit under Section 26(h).

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT

The conclusion of the Court below that a redemption premium distributed out of earnings or profits does not constitute a "dividend" under the Internal Revenue Code was derived from both the meaning of "dividends paid" in Section 26(h), and the meaning of the term "dividend"

in Section 115(a) (26 U.S.C. 1952 Ed. Sec. 115(a)), which defines the term for purposes of the income tax generally. From both points of view, it constitutes an incorrect decision of an important question of law in the administration of the Internal Revenue Code which has not been, but should be, settled by this Court.

I. The Decision Below Was Incorrect

First: The decision below is at odds with the Congressional purpose in enacting Section 26(h). Concededly, that provision was intended to analogize the deductibility of dividend payments on utility company preferred stocks to the deductibility of interest payments on debt securities. *Public Service Electric and Gas Co.* v. *United States* 157 F. Supp. 846 (1958). The reason for this was that regulatory requirements had forced utility companies to finance their extensive capital needs through stock rather than debt, and as a result they were deprived of the interest deductions which the Internal Revenue Code offered to those businesses which were free to resort to debt financing. The impact of this deprivation was so accentuated by the adoption in 1942 of the high wartime surtax rates, that Section 26(h) was enacted (as Section 133 of the Revenue Act of 1942, 56 Stat. 798, 830) to ameliorate the disadvantage to which utility companies were thus subjected.

Economically, there is no doubt that redemption premiums are part of the interest cost to the issuer of a debt security. Recognition of this underlies both Treasury Regulations and Court decisions allowing a deduction for the payment of premiums on the redemption of bonds equally with a deduction for the payment of current interest on those bonds. Reg. 103, Section 19.22(a)-18; Pars. (1)(b) and (3)(b) and similar provisions in prior regulations; cf. *Metropolitan Edison Co.* v. *Commissioner*, 98 F. 2d 807 (C.C.A. 3, 1938), affd 306 U. S. 522 (1939); *Indiana Lamp Corporation*, 28 B.T.A. 491 (1933), Acq.

XIII-1 CB 8.* In the case of utility companies, which are in need of constant financing for new capital and refinancing to take advantage of shifts in money rates, the character of the redemption premium as another aspect of interest is underscored. In deference to the role of such continuous refinancing in utility company economics, and to the constant regulatory pressure upon public utilities to replace bonds with stock, Congress in 1943 (Section 116, Revenue Act of 1943; 58 Stat. 21, 36) extended the dividends paid credit, which it had provided in 1942 only for previously issued preferred stocks, to preferred stocks which were issued to replace previously outstanding bonds or preferred stocks. This legislative background suggests neither distinction nor reason for distinction between redemption premiums and recurrent periodic payments in measuring the scope of the dividends-paid credit thus provided for public utility companies.

Since the policy embodied in Section 26(h) applies equally to redemption premiums and to recurrent periodic dividends, to conclude that Section 26(h) does not embrace redemption premiums would require a showing either that Congress explicitly contemplated exclusion of redemption premiums from the credit or that its use of the word "dividends" embodies such an intention. Concededly, the former showing cannot be made since, as the Court below pointed out (p. 27, *infra*), there is nothing to suggest that Congress addressed itself explicitly to the problem of redemption premiums such as are here involved. This leaves as the only basis for denial of the credit for redemption premiums the argument that the term, "dividend", as it is generally used in the Code does not embrace redemption premiums.

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* Significantly for present purposes, this deduction was allowed even though, under another provision of the 1939 Code (Section 117(f), 26 U. S. C. 1952 Ed. Sec. 117(f)), receipt of the redemption premium by the bondholder was taxable as a capital gain.

Second: The term "dividend" was explicitly defined by Section 115(a) of the 1939 Code "for the purpose of the whole title" (*Commissioner* v. *Bedford's Estate*, 325 U. S. 283, 292 [1945]), to mean "any distribution made by a corporation to its shareholders, * * * out of its earnings or profits". On the face of this definition, no exclusion is made for distributions in liquidation, so that if it stood alone, as this Court pointed out in *Hellmich* v. *Hellman*, 276 U. S. 233, 236 (1928), the "broad definition of the term 'dividend' would apparently include distributions made to stockholders * * * in liquidation". The question is whether Section 115(c) which deals with distributions in liquidation,* requires a different result, since the redemption of preferred stock in this case, which entailed a distribution out of earnings or profits to the extent of the redemption premiums, was also a distribution in partial liquidation.

There is no doubt that, from the point of view of the distributee shareholder, Section 115(c), by providing for capital gain or loss treatment, qualifies the tax consequences of the definition of "dividend" in Section 115(a). *Hellmich* v. *Hellman, supra.* From the point of view of the distributing corporation, however, Section 115(c) contains no such qualification of the tax consequences, or of the conception,

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* Section 115(c) (26 U. S. C. 1952 Ed. Sec. 115(c)) provides in relevant part:

> "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits."

"dividend", contained in Section 115(a). On the contrary, the last sentence of Section 115(c), particularly when read in conjunction with Section 115(b),* makes plain that insofar as the portion of a distribution in retirement of preferred stock exceeds the amount properly chargeable to capital, it *must* be charged to earnings and profits. *Helvering v. Jarvis,* 123 F. 2d 742 (C.C.A. 4, 1941); *Alexander Hamilton Rice,* P-H 1942 T.C. Memo Dec. Par. 42,663; G.C.M. 23,460, 1942-2 CB 190. To the extent of that charge to earnings and profits, the distribution is being made out of earnings or profits and therefore is a "dividend" as that term is defined in Section 115(a).

That Section 115(c) was designed to affect the distributee shareholder differently from the distributing corporation is the teaching of its history as well as its language. From the point of view of the *taxation of the stockholder,* Congressional treatment has varied from that of treating the entire distribution in liquidation as an ordinary dividend under the 1916 and 1917 Acts, to classifying the transaction as an exchange of stock for assets under the 1918 Act, to restoring dividend treatment under the 1921 Act, to subjecting the stockholder to capital gains treatment under the 1924 Act. Beginning with the 1934 Act, Congress treated the entire gain on the transaction as short term gain so as "to prevent avoidance of surtax through liquidating dividend"** and finally in 1942 it adopted the provision that has been in effect ever since, which fully assimilates distributions in liquidation to sales or exchanges

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* Section 115(b) of the 1939 Code (26 U. S. C. 1952 Ed. Sec. 115(b)) provides in relevant part that "every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits." See *Foster v. United States,* 303 U. S. 118 (1938).

** H.R. Rep. 704, 73rd Cong., 2d Sess. (1934) p. 29, 1939-1 CB [Part 2] p. 576.

of stock, as either long or short term gains or losses depending on the holding period.*

The treatment of the impact of the distribution in partial liquidation *on the distributing corporation* has had a quite different history from that of the taxation of the stockholder, and unlike the vacillation and changes in stockholder tax treatment, has remained virtually unchanged since 1924. Prior to the 1924 Act, there was no provision in the predecessor of Section 115(c) (Section 201(c)) which dealt with partial liquidations from the point of view of the corporation. In enacting the Revenue Act of 1924, however, Congress became concerned with the possibility that in view of the mandate of Section 201(b), (the predecessor of Section 115(b)) requiring all distributions to be made first from earnings or profits, it would be possible for a corporation to charge to earnings or profits the entire amount distributed in a partial liquidation (i.e., the return to the stockholder of the capital that had been paid into the corporation, as well as any redemption premium) even though the transaction was, except to the

* See summary of the operation of the Revenue Acts of 1916 through 1921, inclusive, in *Frank D. Darrow*, 8 B. T. A. 276 (1927), Acq. VII—1 C B 8. The relevant provisions of the 1924 Act are Section 201(a) and Section 201(c) (43 Stat. 253, 254, 255). Under the 1924 to 1932 Acts, inclusive, the gains to stockholders were treated as long-term capital gains if the stock was held for the appropriate period. But because Congress felt that "liquidating dividends * * * contain some of the elements of * * * a distribution of corporate earnings and profits" (see H.R. Rep. 704, 73rd Cong. 2d Sess. (1934) pp. 29-30, 1939-1 CB [Part 2], p. 576), the 1934 Act treated gains from such liquidating distributions as short term capital gains (Rev. Act of 1934, Secs. 115(c) and 117, 48 Stat. 680, 711, 714-715). This treatment continued until the adoption of the 1942 Act, when the provision was removed, and gains from liquidating distributions were taxed to stockholders as long-term capital gains if the stock was held for the prescribed period. Congress instead relied on Section 115(g) to treat as taxable, dividends which are disguised as liquidations. Compare Section 115(c), before and after its amendment by Section 147 of the Revenue Act of 1942, 56 Stat. 798, 841. See H.R. Rep. 2333, 77th Cong., 2d Sess. (1942) p. 49; see also Albrecht, "Dividends" and "Earnings or Profits", 7 Tax L. Rev. 157 (1952).

extent of premium or other excess amount returned on the stock, really a retirement of capital.* Consequently, Congress provided that in the case of amounts distributed in partial liquidation, "the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subdivision (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation". (Section 201(c), Rev. Act of 1924). This language of the predecessor of Section 115(c) remained unchanged in all later acts until Congress in the 1936 Act (49 Stat. 1648, 1687-1688), without explanation, dropped the phrase, "within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation."

This history leaves no warrant either for altering the explicit language of Sections 115(a) and 115(c) so as to take out of the definition of "dividend" in Section 115(a) as applied to the paying corporation, distributions from earnings or profits which are taxed as capital gains to stockholders, or for the notion that there is a requirement of symmetry in the treatment of a distribution in liquidation by the stockholder receiving it and by the corporation making it.**

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* See H.R. Rep. 179, 68th Cong., 1st Sess. (1924), pp. 11-12, 1939-1 CB [Part 2] p. 250; see also the statement to the Committee by The Treasury Department, *Seidman's Legislative History of Federal Income Tax Laws* [1938-1861] p. 679.

** Differences in the treatment of the same dividend by the distributing corporation and the distributee stockholder were not only specifically contemplated by the successive changes made in Section 115(c), but are well recognized in other contexts in the tax law. See *e.g., Commissioner* v. *Godley's Estate*, 213 F. 2d 529 (C. A. 3, 1954), cert. den. 348 U. S. 862 (1954); *Commission* v. *Hirshon Trust*, 213 F. 2d 523 (C. A. 2, 1954), cert. den. 348 U. S. 861 (1954); see also, Rev. Rul. 57-421, IRB No. 1957-38, p. 15. See, generally, for a discussion of the occasions and policy bases for distinguishing between the corporation and its stockholders in the treatment to be accorded the distribution of

II. The Question Presented is of Importance in the Administration of the Internal Revenue Laws and Calls For Resolution By This Court Now.

The question presented by this case is not confined to the operation of the Internal Revenue Code of 1939. Although the pattern of the Code provisions has changed, for present purposes the provisions of the 1939 Code appear in substantially the same language in the Internal Revenue Code of 1954.* Whether the decision below rests upon the meaning of "dividends" in Section 26(h) or, as the Court below indicated (p. 28, *infra*), upon the general definition of "dividends" for purposes of the entire Chapter of the Code, the issue presented is sufficiently important and pervasive to require resolution by this Court now.

First: A survey of preferred stocks of public utility companies which would apparently qualify under Section 26(h)** discloses that, apart from stocks which may be issued in the future for refunding purposes, there are outstanding at least 235 issues of preferred stocks of public utility companies operating in all 48 states which may give rise to the question here presented. While precise figures as to the amounts of redemption premiums involved are not readily available, it is abundantly clear that they are substantial enough to require public utilities to raise the question here presented until the meaning of the term "dividends" in Section 26(h) is definitively resolved. And the locations of the companies indicate that the question can be raised in any of a number of District Courts. Thus, although the issue was presented in the instant case and in

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earnings and profits, Rudick, "Dividends" and "Earnings or Profits" under the Income Tax Law: Corporate Non-Liquidating Distributions, 89 U. of Pa. L. Rev. 865, 879, *et seq.*, (1941).

* See Sections 247, 316, 302, 331 and 312, 68A Stat. 75-76, 98-99, 85-87, 101, 95-96.

** See Sinclair-Murray Capital Changes Reporter, distributed by Commerce Clearing House, Inc., Vol. 3, pp. 6501-6542.

five others in the Court of Claims*, it is now pending in at least one other case in a District Court.** The decision below suggests that, if raised again, the issue will be presented to other District Courts. Hence, although there is now no conflict because the Court of Claims alone has passed on the question, the possibility of conflict—indeed, in view of the merits of the case and the equivocal opinion below, the likelihood of conflict—is real, not merely fancied. In such circumstances, sound judicial administration does not permit postponement of the resolution of this question by this Court.

Second: The need for action by this Court is made more compelling by the fact that the decision below is not confined to the meaning of "dividends" for purposes of Section 26(h). The shadow cast by the opinion below beclouds the scope of "dividends" whenever the consequences to the distributing corporation are at issue. Concretely, for example, the decision below is not unrelated to the meaning of "dividends" for purposes of exchanges such as were involved in the *Idaho Power Company* case (161 F. Supp. 807), which was decided by the Court of Claims on the same day as the instant case and in which we are informed a petition for certiorari will be sought. Moreover, the exclusion of liquidating distributions made from earnings or profits, from the concept of "dividends" paid by the distributing corporation, conflicts with the meaning given to the term "dividends" in other dividends paid credits provided by Congress.

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* See also *American Gas & Electric Co.* v. *United States* (Ct. Cl. No. 34-55); *Indiana & Michigan Electric Co., In Its Own Behalf and As Successor By Merger To Indiana General Service Co.* v. *United States* (Ct. Cl. No. 397-54); *Wheeling Electric Co.* v. *United States* (Ct. Cl. No. 32-55); *Atlantic City Electric Company* v. *United States*, 161 F. Supp. 811 (1958); *Idaho Power Company* v. *United States*, 161 F. Supp. 807 (1958).

** *Kentucky Utilities Company* v. *Glenn and Gray* (Civ. Act. No. 3516, W.D. Ky.).

Thus, as the Court below noted (p. 27, *infra*), the term "dividends" in the bill which became Section 121 of the 1939 Code was deemed by the Secretary of the Treasury to cover distributions in liquidation, and because the particular policy considerations there involved precluded extension of that dividends-paid deduction to such distributions, they were expressly excluded therefrom.* Similarly, the term "dividends" in the credit which Section 351 of the Revenue Act of 1934 (48 Stat. 680, 752) extended to personal holding companies for dividends paid was construed by the Courts to include distributions in liquidation to the extent made out of earnings or profits (*Piper* v. *United States*, 50 F. Supp. 363 (D. C. Minn., 1943); *Pembroke Realty & Securities Corporation* v. *Commissioner*, 122 F. 2d 252 (C. C. A. 2, 1941)), although not without disagreement.**

Finally, in Section 27 of the Revenue Act of 1936 (49 Stat. 1648, 1665) which became Section 27 of the 1939 Code (26 U. S. C. 1952 Ed. Sec. 27) where Congress provided a

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* Apparently because government policy sought to discourage the issuance by banks of preferred stocks redeemable at a premium (See Act of August 23 (1935), Public Law 305, 74th Cong., 1st Sess., Chap. 614, Section 345; 49 Stat. 684, 722-723), the Treasury opposed extension of the deduction to distributions in liquidation —*i.e.*, redemption premiums on such preferred stocks—and they were excluded by Congress from the deduction. (See Public Law 374, 74th Cong. 1st Sess., Sec. 3, 49 Stat. 908). The Secretary of the Treasury requested the House Ways and Means Committee by letter dated July 18, 1935 to exclude liquidating distributions expressly from the term "dividends" contained in the pending bill, because "the term 'dividends' is too broad and should be qualified by excepting therefrom any so-called distributions in liquidation which are sometimes designated as 'liquidating dividends'". This letter is referred to in H.R. Rep. 1759, 74th Cong., 1st Sess. (1935) at p. 4, and is in the files of the House Ways and Means Committee.

** See *The Brooklyn National Corporation*, 5 T. C. 892 (1945), affd. 157 F. 2d 450 (C. C. A. 2, 1946) cert. den. 329 U. S. 733 (1946); *Gaston & Company Inc.*, 39 B. T. A. 640 (1939). In 1936, Congress made clear that this credit to personal holding companies included liquidating distributions by making it part of the general dividends-paid credit provided by Section 27 of the Revenue Act of 1936. (See Section 351, 49 Stat. 1648, 1732).

general "dividends paid" credit to encourage the distribution of undistributed profits, the credit was explicitly made applicable to "amounts distributed in liquidation" to the extent that such distributions were properly chargeable to earnings or profits. See *Helvering* v. *Credit Alliance Corporation*, 316 U. S. 107 (1942). Since application of that credit to liquidating distributions was a limitation upon the basic policy of Section 27—to enable undistributed corporate profits to be taxed as ordinary income in the hands of the stockholders—Congress felt obliged to include liquidating distributions explicitly in the credit, rather than to rely on the normal meaning of the word "dividends" to embrace such distributions. But, the fact that Congress thus gave a credit for distributions in liquidation under Section 27, where it was concerned essentially with taxing the recipient, emphasizes the incongruity of the ruling below that under Section 26(h), where Congress focused on extending the credit to the distributing corporation without regard to the tax consequences to the recipient, the word "dividends" should be construed to exclude appropriate portions of distributions in liquidation.

The Court below acknowledged (p. 28, *infra*) that this Court had never passed on the questions involved in this case and that the issues presented were "so evenly balanced, on the basis of the text of the statutes and the logical inferences to be drawn from them," that it was forced to reach its results by following expressions of this Court and other courts on related questions which were not necessary to the decisions there involved. See *Hellmich* v. *Hellman*, *supra* at 236-237 (1928); *Helvering* v. *Credit Alliance Corporation*, *supra* at 110 (1942); *The St. Louis Company* v. *United States*, 237 F. 2d 151 (C. A. 3, 1956) cert. den. 352 U. S. 1001 (1957); *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. 2d 177, 181-183 (C. C. A. 7, 1944); but *cf. Pembroke Realty & Securities Corporation* v. *Commissioner*, *supra*. The decision below, like the state of the law on which it rests, reflects conflict and uncertainty

in a variety of contexts about the inclusion of portions of liquidating distributions in "dividends" from the corporation's point of view. Such confusion calls imperatively for clarification by this Court.

CONCLUSION

The Writ of Certiorari to the United States Court of Claims Should Be Granted.

Respectfully submitted,

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VICTOR BRUDNEY,
Of Counsel

July 25, 1958

APPENDIX A

Order of the United States Court of Claims Dismissing Petition.

ORDER

This case comes before the court on a stipulation of facts and briefs filed by the parties. Upon consideration thereof, and on the basis of the facts as stipulated by the parties and the decision of this date in *Atlantic City Electric Company* v. *United States*, No. 33-55,

IT IS ORDERED this seventh day of May, 1958, that plaintiffs' petition be and the same is dismissed.

BY THE COURT

/s/ Marvin Jones

MARVIN JONES,
Chief Judge.

NOTE: The decision of the court in *Atlantic City Electric Company* v. *The United States*, No. 33-55, as mentioned above follows:

Appendix A

IN THE

UNITED STATES COURT OF CLAIMS

No. 33-55

(Decided May 7, 1958)

ATLANTIC CITY ELECTRIC COMPANY v. THE UNITED STATES

(Names of counsel omitted)

Opinion

MADDEN, *Judge*, delivered the opinion of the court:

The plaintiff sues for $84,105.60 of income tax paid by it for the year 1944. It claims that it should not have had to pay this tax because it was entitled to a credit which would have reduced its taxable income.

Section 26 (h) of the Internal Revenue Code of 1939 provided that a public utility corporation, in computing its surtax net income, was entitled to a credit for, i. e., a deduction of, "the amount of dividends paid during the taxable year on its perferred stock." The plaintiff was a public utility, and the stock in question qualified in all respects for the benefits of section 26 (h). The question is whether the payments made by the plaintiff during 1944 were "dividends" within the meaning of section 26 (h).

In *Public Service Electric and Gas Co. v. United States*, No. 318-56, — C. Cls. —, decided January 15, 1958, this court discussed the reason for the enactment by Congress of section 26 (h). It there appears that Congress desired to give to public utility companies which had financed themselves by issuing preferred stock a status, for tax purposes, similar to that of such corporations which had financed

themselves by issuing bonds. Since the interest on the bonds was deductible, dividends on preferred stock were made deductible.

The payments which the plaintiff made to its stockholders, and sought to deduct from its taxable income, were not the payments of $6 per share which accrued annually on its preferred stock and which, under the terms of that stock, had to be paid before the common stockholders could be paid any dividends. The payments here in question were payments of $20 per share, in addition to the $100 par value of the preferred shares, for the redemption of the stock. The preferred stock as issued provided that the plaintiff corporation could, at its option, redeem the shares for $120 plus accrued dividends, and the plaintiff did so redeem them. The accrued dividends so paid were clearly deductible under the provisions of section 26 (h), and they are not involved in this case. The redemption payments of $20 per share are the payments in question. As we have said, the question is whether they were "dividends" within the meaning of section 26 (h).

To the layman, a payment to a shareholder of a sum in addition to the regular dividends provided for in his stock certificate, a sum which would never be paid again because it was paid for the redemption and cancellation of the stock, would not be regarded as a dividend. But the meaning of a word in the tax statutes is not a question for a layman, unless the by no means impossible situation occurs when, as a last resort, refuge is taken in the lay meaning.

Since section 26 (h) merely uses the word "dividend" without definition, one must look elsewhere in the statutes to learn whether it applies to the instant situation in which the payment was not obviously a dividend. The plaintiff points to section 115 (a) of the Internal Revenue Code of 1939 for the definition of "dividend" for the instant purpose. That section says:

Appendix A

> The term "dividend" * * * means any distribution made by a corporation to its shareholders * * * out of its earnings or profits * * *.

The $20 per share payment in question was made out of accumulated earnings of the plaintiff. Therefore, the plaintiff says, it was by definition a dividend and was covered by the language of section 26 (h).

The Government says that before one reaches a conclusion as to the effect of the broad definition of dividend in section 115 (a), one must look at section 115 (c), which provides for "Distributions in liquidation" and says:

> Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation * * * as in part or full payment in exchange for the stock.

The payments of the $120 per share for the redemption of the $100 par value stock liquidated the stock. According to section 115 (c), the entire $120 was taxable to the stockholder who received it, if it was taxable at all, only to the extent that the $120 represented a capital gain to the distributee-shareholder, and was taxable only at capital gains rates. It might well have involved no capital gain to him at all, as, for example, if he had paid $120 per share for the stock.

The Government says that section 115 (c), in saying that amounts distributed in liquidation shall be treated as "payment in exchange for the stock," not only means that they shall be so treated in the hands of the distributee-shareholder, but that they shall be so treated as regards the distributor-corporation. If they are so treated, the corporation has, for tax law purposes, not distributed a dividend, but bought a share of stock. That would not entitle it to any deduction under section 26 (h).

Appendix A

The Government urges that it would be an illogical and asymmetrical reading of section 115 (c) to regard it as applying only to the distributee-shareholder side of the redemption transaction, and not to the distributor-corporation side. There would, however, have been a valid reason for the distinction, if Congress chose to make the distinction. From the corporation's side, the money distributed was earnings which had accumulated in its treasury. As we have suggested above, to the distributee-shareholder it may not have represented any profit at all. He may well have, in the money market of those times, regarded a 6 percent preferred stock redeemable at $120 as worth $120, or $110, and have paid that much for it, so that the $20 was not, or was not all, profit or other income. A similar situation might occur with regard to unpaid cumulative preferred stock dividends which were finally paid, as dividends, but for most of which the shareholder had already paid when he purchased the stock in the market. Section 115 (c) would not take care of such a taxpayer. Whether any other provision of law would help him we do not know.

We are not persuaded, then, by the Government's argument for symmetry in the interpretation of section 115 (c). We think it is fair for the plaintiff to urge that the definition in section 115 (a) covers its case, and is not negatived by section 115 (c).

The plaintiff points to another provision which is in the third sentence of section 115 (c) and which says:

> In the case of amounts distributed * * * in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

The plaintiff says that this sentence contains a negative inference that the part of a distribution in partial liquidation which *is* properly chargeable to earnings, and hence not

"properly chargeable to capital account" is a distribution of earnings and is therefore a dividend, within the definition of section 115 (a). The statement in the sentence quoted above is a statement of the obvious. The Government says it was inserted to clarify the question whether, when a corporation had earnings accumulated prior to 1913, and redeemed a part of its stock at prices which took into account the value created by the pre-1913 earnings, and later distributed a dividend, the distributee could claim that the earlier distribution exhausted the post-1913 earnings and hence the later distribution was from the pre-1913 earnings and was tax free. In fact, in an earlier version of this sentence of section 115 (c), *viz.* section 201 (c) of the Revenue Act of 1924, 43 Stat. 253, it expressly said that distributions properly chargeable to capital account should not be considered as distributions of earnings or profits "for the purpose of determining the taxability of subsequent distributions by the corporation." The Revenue Act of 1936, 49 Stat. 1648, dropped the limiting language just quoted, but Congress gave no reason for dropping it.

Our consideration up to this point shows a definition in section 115 (a) which would make the plaintiff's distribution a "dividend" for all purposes, including the purpose of the section 26 (h) deduction, and a miscellany of provisions in section 115 (c) which qualify the definition given in 115 (a). The first sentence in 115 (c) says that distributions in liquidation, though they would be dividends within the definition of 115 (a), shall not be treated, for tax purposes, as dividends, but shall be treated as payments of purchase price of the liquidated stock. This sentence does not tell us whether these payments should be so treated as regards both the distributee-shareholder and the distributor-corporation or only as regards one of them. The second sentence of section 115 (c) which provides for determination and recognition of gain or loss is expressly applicable only to the

distributee-shareholder. The third sentence could be applicable to both parties to the transaction, but the negative inference which it contains cannot have the effect of making the distributions of earnings taxable to the distributee as dividends, without contradicting the first and second sentences of the same section. The foregoing summary shows that the statutory situation is confused.

There have been other situations in which it has been advantageous to taxpayers to show that distributions made, or received, were dividends. We consider those situations for possible enlightenment on our problem.

Section 216 (a) of the Revenue Act of 1918, 40 Stat. 1057, 1069, allowed taxpayers a tax credit for the "amount received as dividends from a corporation." In *Hellmich* v. *Hellman*, 276 U. S. 233, the taxpayer had received, in a distribution in liquidation of a corporation, money which had been accumulated as earnings of the corporation. He claimed the credit, pointing to the definition of dividends in section 115 (a), which was section 201 (a) of the Revenue Act of 1918. The Court held that he was not entitled to the credit, in spite of the 115 (a) definition of dividends because 115 (c), then 201 (c), expressly provided that the payments in liquidation should be treated as the purchase price of the liquidated stock. The Court said, at pages 236-237:

> It is true that if § 201 (a) stood alone its broad definition of the term "dividend" would apparently include distributions made to stockholders in the liquidation of a corporation—although this term, as generally understood and used, refers to the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business, which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock. See *Lynch* v. *Hornby*, 247 U. S. 339, 344-346; and *Langstaff* v. *Lucas* (D. C.) 9 F. (2d) 691, 694.

However, when § 201 (a) and § 201 (c) are read together, under the long-established rule that the intention of the lawmaker is to be deduced from a view of every material part of the statute, *Kohlsaat* v. *Murphy*, 96 U. S. 153, 159, we think it clear that the general definition of a dividend in § 201 (a) was not intended to apply to distributions made to stockholders in the liquidation of a corporation, but that it was intended that such distributions should be governed by § 201 (c), which, dealing specifically with such liquidation, provided that the amounts distributed should "be treated as payments in exchange for stock" and that any gain realized thereby should be taxed to the stockholders "as other gains or profits." This brings the two sections into entire harmony, and gives to each its natural meaning and due effect. The Treasury Regulations correctly interpreted the Act as making § 201 (a) applicable to a distribution made by a going corporation to its stockholders in the ordinary course of business, and § 201 (c) applicable to a distribution made to stockholders in liquidation of the corporation. And this is in accord with the rulings of the Board of Tax Appeals. *Appeal of Greenwood*, 1 B. T. A. 291, 295; *Appeal of Chandler*, 3 B. T. A. 146, 149.

The *Hellmich* case was, of course, concerned with the status of the distributed money in the hands of the distributee, as a dividend *vel non*. The Court's language, like the language of the statute, does not tell us whether the payment would have the nondividend status as regards the distributor-corporation, which is our problem in the instant case. The Treasury Regulation approved by the Court, Treasury Regulations 45 (1919 ed.) Art. 1548, is as broad as the statute and the Court's opinion. *Foster* v. *United States*, 303 U. S. 118, affirming 84 C. Cls. 193, was another

case in which the status of the payment in the hands of the distributee-shareholder was involved, and the decision was that the broad definition of dividends in 115 (a) was overridden by the specific provisions of 115 (c).

The plaintiff says that the language of section 115 (c) and of the judicial opinions and of the executive regulations should be limited to the situation which, the plaintiff says, all of the users of the language had in mind, *viz*, the status of the money in the hands of the distributee.

We now consider a comparable statutory situation in which the important question is the one involved in the instant case, *viz*, the status of the distribution from the standpoint of the distributing corporation. For the purpose of compelling the distribution of corporate profits so that they could be taxed in the hands of the shareholders, Congress in section 14 of the Revenue Act of 1936, *supra*, imposed a surtax on undistributed corporate profits. See *Reed Drug Co.* v. *Commissioner*, 130 F. 2d 288 (C. A. 6). In the section which became section 27 (g) of the Internal Revenue Code of 1939, Congress provided a credit against the undistributed profits taxes for that part of a distribution in liquidation which was properly chargeable to earnings and profits. The section provided that such a payment should be "treated as a taxable dividend paid."

The Government says that if the plaintiff is right in its claims as to the universality of the definition of dividend in section 115(a) and the one-sidedness of the provision in the first sentence of section 115 (c), limiting its capital gains treatment to the funds in the hands of the distributee, there would have been no reason for the insertion of section 27 (g). It says that, under the plaintiff's assumptions, the payments described in section 27 (g) would of course have been dividends and would have been covered by the general language giving credit for dividends paid, without any need for being specially "treated as a taxable dividend paid."

We think there is force in the Government's argument. We wish Congress had been equally specific and clear in its writing of section 26 (h), with which we are here concerned.

In *Helvering* v. *Credit Alliance Corp.*, 316 U. S. 107, the corporation had distributed accumulated earnings in a liquidation transaction and claimed the statutory credit for dividends paid. The Court said, at page 110:

> Although a distribution in liquidation of earnings * * * does not constitute a dividend in the proper sense of the term,[1] subsection (f)[2] categorically declares that a liquidating distribution, to the extent it is composed of such earnings, shall, for the purposes of computing the dividends-paid credit "*be treated as a taxable dividend paid.*"

In *St. Louis Co.* v. *United States*, 237 F. 2d 151 (C. A. 3), *cert.* den. 352 U. S. 1001, the corporation taxpayer claimed a dividends-paid credit for payments made in a distribution in liquidation. It had a deficit balance of accumulated earnings, but it had current earnings in the year of distribution. Under the definition of dividends in section 115 (a) and the provisions of section 115 (b), applied without consideration of section 115 (c), its contention would have been right. But the Court held that the statutes made a distinction between distributions made by a going corporation and those made by a corporation in liquidation; that in the latter case the distributions in liquidation would be treated as dividends only if a statute such as section 27 (g) specifically so provided, and that the taxpayer's situation did not comply with section 27 (g) because it did not have accumulated earnings, but a deficit. In *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. 2d 177 (C. A. 7), the court gave similar treatment to a comparable situation.

---

[1] The Court here cited *Helmich* v. *Hellman*, *supra*.

[2] Section 27 (g) of the Internal Revenue Code of 1939.

Another instance of a "dividends paid" credit in the statutes is a section of a 1935 Act, 49 Stat. 908, which became section 121 of the Internal Revenue Code of 1939, which gave to banks and domestic insurance companies a tax deduction for dividends paid on their preferred stock. The Secretary of the Treasury suggested that the bare language in the draft of the bill "any dividend paid" should be qualified by the parenthetical expression "(not including any distribution in liquidation)" and that change was made. It is fair to urge that the change was made because the general language "any dividend paid" would have, without the qualification, included distributions made in liquidation, according to the definition of dividends in section 115 (a).

The plaintiff urges that the purpose of Congress in providing the tax credit to public utility corporations for dividends paid on preferred stock will be, in part, frustrated if they are not allowed such credit for distributions in liquidation. It should be said that there is no evidence whatever that Congress put its mind on the particular question here involved. The plaintiff's argument is that the purpose of Congress was to give to public utility corporations which had financed themselves by issuing preferred stock the same tax status as those which had financed themselves by issuing bonds. The only payments discussed by the witnesses who spoke for 26 (h) were the regularly recurring, cumulative, charges in the form of dividends on preferred stock which corporations which so financed themselves had to pay. The more esoteric questions of tax treatment of the issuance of bonds at a premium or at a discount, or their redemption at a premium or at a discount, and how similar tax treatment of preferred stock so issued or so redeemed could be provided for, were not raised. If they had been, they might well have confused the principal objective of the legislation, which was to get the tax credit for the normal

recurring payments which all persons would recognize as dividends.

We get no real help from a consideration of the purpose of the legislation. We are obliged to conclude that Congress meant by the word dividends in section 26 (h) whatever meaning the applicable statutes gave to the word in its proper context. We are, therefore, thrown back upon section 115 and its several subsections. As our discussion has indicated, section 115, and other legislation relating to analogous situations, give rise to conflicting inferences.

Our instant problem has not been decided by any court. The Supreme Court of the United States, and other courts which have adjudicated related problems, have said in effect that the general definition of dividends in section 115 (a) is not applicable to distributions in liquidation; that to whatever extent they are to be treated as dividends, the justification must be found in section 115 (c) or elsewhere. We recognize that most, perhaps all, of such decisions could have been reached without the use of language as inclusive as that used by the courts. We cannot, however, ignore these expressions of opinion.

The question being so evenly balanced, on the basis of the text of the statutes and the logical inferences to be drawn from them, we are persuaded by the expressions of the other courts to the conclusion that the distribution here in question was not a dividend within the meaning of section 26 (h).

The plaintiff's petition will be dismissed.

It is so ordered.

LARAMORE, *Judge;* WHITAKER, *Judge;* LITTLETON, *Judge;* and JONES, *Chief Judge,* concur.

(The Findings of Fact of the Court of Claims in *Atlantic City Electric Company* v. *The United States* have been omitted.)

APPENDIX B

Relevant Provisions of the Internal Revenue Code of 1939, Effective for the Year 1947.

SEC. 26. CREDITS OF CORPORATIONS

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(h) [as added by Section 133 of the Revenue Act of 1942, c. 619, 56 Stat. 798 and amended by Section 116 of the Revenue Act of 1943, c. 63, 58 Stat. 21] CREDIT FOR DIVIDENDS PAID ON CERTAIN PREFERRED STOCK.—

(1) AMOUNT OF CREDIT.—In the case of a public utility, the amount of dividends paid during the taxable year on its preferred stock. For the purposes of the credit provided in this subsection the amount of dividends paid shall not include any amount distributed in the current taxable year with respect to dividends unpaid and accumulated in any taxable year ending prior to October 1, 1942. Amounts distributed in the current taxable year with respect to dividends unpaid and accumulated for a prior taxable year shall for the purposes of this paragraph be deemed to be distributed with respect to the earliest year or years for which there are dividends unpaid and accumulated. The credit provided in this subsection shall be subtracted from the basic surtax credit provided in section 27.

(2) DEFINITIONS.—As used in this subsection and section 15(a)—

(A) Public Utility.—The term "public utility" means a corporation engaged in the furnishing of

telephone service or in the sale of electric energy, gas, or water, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof or by an agency or instrumentality of the United States or by a public utility or public service commission or other similar body of the District of Columbia or of any State or political subdivision thereof.

(B) Preferred Stock.—The term "preferred stock" means stock issued prior to October 1, 1942, which during the whole of the taxable year (or the part of the taxable year after its issue) was stock the dividends in respect of which were cumulative, limited to the same amount, and payable in preference to the payment of dividends on other stock. Stock issued on or after October 1, 1942, shall be deemed for the purposes of this paragraph to have been issued prior to October 1, 1942, if it was issued (including issuance either by the same or another corporation in a transaction which is a reorganization, as defined in section 112(g)(1), or a transaction to which section 112(b)(10), or so much of section 112(d) or (e) as relates to section 112(b)(10), is applicable, or which is a transaction subject to Supplement R) to refund or replace bonds or debentures issued prior to October 1, 1942, or to refund or replace other preferred stock (including stock which is preferred stock by reason of this sentence), but only to the extent that the par or stated value of the new stock does not exceed the par, stated, or face value of the bonds or debentures issued prior to October 1, 1942, or the other preferred stock, which such new stock

was issued to refund or replace. The determination of whether stock was issued to refund or replace bonds or debentures issued prior to October 1, 1942, or to refund or replace other preferred stock, shall be made under regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * *

(26 U. S. C. 1952 Ed., Sec. 26)

Sec. 115. Distributions by Corporations

(a) Definition of Dividend. — The term "dividend" when used in this chapter (except in section 201(c)(5), section 204(c)(11) and section 207(a)(2) and (b)(3) (where the reference is to dividends of insurance companies paid to policyholders)) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. In the case of a corporation which, under the law applicable to the taxable year in which the distribution is made, is a personal holding company, or which, for the taxable year in respect of which the distribution is made under section 504(c) or section 506 or a corresponding provision of a prior income-tax law, is a personal holding company under the law applicable to such taxable year, such term also means any distribution (whether or not a dividend as defined in the preceding

sentence) to its shareholders, whether in money or in other property, to the extent of its subchapter A net income, less the sum of the following:

(1) The net operating loss credit provided in section 26(c)(1);

(2) The dividend carry-over provided in section 27(c); and

(3) The deduction for amounts for retirement of indebtedness provided in section 504(b).

* * * * *

(c) Distributions in Liquidation. — Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. If any distribution in partial liquidation or in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) is made by a foreign corporation which with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was a foreign personal holding com-

pany, and with respect to which a United States group (as defined in section 331(a)(2)) existed after August 26, 1937, and before January 1, 1938, then, despite the foregoing provisions of this subsection, the gain recognized resulting from such distribution shall be considered as a gain from the sale or exchange of a capital asset held for not more than 6 months.

* * * * *

(i) Definition of Partial Liquidation.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * *

(26 U.S.C. 1952 Ed., Sec. 115)

Relevant Provisions of the Governing Regulations for the Year 1947, Regulations 111.

Sec. 29.115-1. [as amended by T. D. 5377, 1944 CB 257] Dividends.—The term "dividend" for the purpose of chapter 1 (except when used in section 201(c)(5), section 204(c)(11), and section 207(a)(2) and (b)(3) where the reference is to dividends of insurance companies paid to policyholders) comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of either—

(1) earnings or profits accumulated since February 28, 1913, or

(2) earnings or profits of the taxable years computed without regard to the amount of the

earnings or profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.

The earnings or profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.

* * * * *

The term "dividend" does not include distributions under section 115(c), relating to distributions in liquidation, section 115(e), relating to distributions by personal service corporations. For treatment of any distribution made prior to October 21, 1942, which is a dividend solely by reason of the last sentence of section 115(a), see section 29.504-3.

* * * * *

Sec. 29.115-5. Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so cancelled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and section 29.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112, and shall be subject to the conditions and limitations provided in section 117.

* * * * *

Appendix B

In the case of amounts distributed in partial liquidation, the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of section 115(b) for the purpose of determining taxability of subsequent distributions by the corporation. (See sections 29.27(g)-1 and 29.115-11.)

Sec. 29.27(g)-1. DIVIDENDS PAID CREDIT FOR DISTRIBUTIONS IN LIQUIDATION.—

* * * * *

(b) *Amount properly chargeable to earnings or profits.*—In the case of a distribution in liquidation with respect to which an allowance for dividends paid is permissible (see paragraph (a) of this section) the amount of the allowance is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. The capital account, for purposes of these regulations, includes not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and such other corporate items, if any, which, for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock. The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated since February 28, 1913.

APPENDIX C

IN THE

UNITED STATES COURT OF CLAIMS

No. 204-56

GENERAL PUBLIC UTILITIES CORPORATION, as common parent corporation of an affiliated group of corporations, et al.,
Plaintiffs,

v.

UNITED STATES OF AMERICA,
Defendant.

Stipulation of Facts

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts may be taken as true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true; and, provided, further, that said facts are stipulated subject to objections by either party as to materiality or relevancy:

1. General Public Utilities Corporation (hereinafter referred to as "GPU") is, and at all times hereinafter mentioned was, a corporation duly organized and existing under the laws of the State of New York. It is, and at all times hereinafter mentioned was, engaged in business as a public utility holding company, with its principal office and place of business in New York, New York.

2. All the plaintiffs were domestic corporations at all times hereinafter mentioned and the address of GPU is

67 Broad Street, New York, N. Y. All plaintiffs now in existence are domestic corporations.

3. At all times during the calendar year 1947, GPU was the common parent corporation of an affiliated group of corporations, as defined in Section 141 of the Internal Revenue Code of 1939, as amended. The members of said affiliated group of corporations (hereinafter referred to as "the affiliated group") included New York State Electric & Gas Corporation (hereinafter referred to as "New York State") and all the other plaintiffs herein.

4. On September 15, 1948, and within the time permitted by extensions theretofore duly granted, GPU, as common parent corporation of the affiliated group, duly filed with the Collector of Internal Revenue for the Second District of New York a consolidated Federal income tax return for the calendar year 1947, on its own behalf and on behalf of the other corporations of the affiliated group, reporting thereon no liability for Federal income taxes for the calendar year 1947.

5. After investigation and report by a Revenue Agent, dated March 30, 1953, determining that the consolidated net income of GPU and the other members of the affiliated group for the calendar year 1947 was the amount of $12,933,820.08 and that the consolidated surtax net income of said affiliated group for the calendar year 1947 was the amount of $10,231,660.26, the Commissioner of Internal Revenue (hereinafter referred to as "the Commissioner") determined Federal income tax against the affiliated group for such year in the sum of $4,721,816.02, together with interest thereon in the amount of $1,440,153.89, making a total of $6,161,969.91. Annexed hereto as Exhibits A and B are copies of the letter of the District Director of Internal Revenue, dated May 20, 1953, transmitting the aforesaid Revenue Agent's Report and excerpts from such Report.

6. In making the aforesaid determination, the Commissioner disallowed in full a credit taken on the consolidated return of $600,000 against net income under Section 26(h) of the Internal Revenue Code of 1939, in determining the consolidated surtax net income of the affiliated group by reason of the payments made to its stockholders by New York State during the calendar year 1947 in the redemption of its 5.10% cumulative preferred stock, as is hereinafter more fully set forth.

7. On April 15, 1953, GPU on its own behalf and on behalf of the other corporations of the affiliated group paid to the Director of Internal Revenue for the Second District of New York the sum of $6,161,969.91, which was thereafter assessed on the August 13, 1953 Special 7 Assessment List. Annexed hereto as Exhibit C is a copy of the letter dated April 15, 1953 from GPU transmitting such payment.

8. On February 10, 1954, GPU on behalf of itself and the other corporations of the affiliated group filed a claim for refund of Federal income taxes theretofore paid for the calendar year 1947, claiming, by reason of the Commissioner's failure to allow a credit of $539,192.07 against net income under Section 26(h) of the Internal Revenue Code of 1939, a refund in the amount of $112,583.30, or such larger amount as is legally refundable, together with interest thereon as provided by law. Annexed hereto as Exhibit D is a copy of said refund claim and covering letter.

9. The Commissioner disallowed said refund claim in full and, on August 18, 1955, mailed to plaintiff GPU, by registered mail, a notice of such disallowance. Annexed hereto as Exhibit E is a copy of said notice.

10. On or about July 8, 1941, plaintiff New York State issued and sold to a group of underwriters 120,000 shares of its 5.10% cumulative preferred stock of a par value of $100 per share, redeemable at $105 per share, for a

price of $100.85 per share or an aggregate amount of $12,102,000.00. Annexed hereto as Exhibits F-1 and F-2 are copies of the contract of sale of said stock dated July 1, 1941 and the documents dated July 8, 1941 evidencing the receipt by New York State from the underwriters of the proceeds of such sale.

11. In connection with the issuance and sale of such shares, New York State incurred expenses in the amount of $47,753.99, of which $6,561.92 was stamp tax which was claimed and allowed as a deduction from income in determining New York State's liability for Federal income tax for the year 1941, leaving a balance of $41,192.07 thereof.

12. On January 21, 1947, New York State sold 150,000 shares of 3.75% cumulative preferred stock, $100 par value, at an aggregate price of $15,020,850.00. On the same date New York State sold $13,000,000 principal amount of its first mortgage 2.75% bonds due 1977 for an aggregate price of $13,294,970. The funds thus raised, together with $7,500,000 received as a capital contribution from GPU were utilized to redeem the 120,000 shares of 5.10% preferred stock, the corporation's 3.75% series first mortgage bonds due 1964 in the principal amount of $13,000,000, interest and dividends accrued to the date of redemption, the costs and expenses of the new issues, and to provide a balance of approximately $9,160,000 for new construction.

13. In December 1946, New York State debited earned surplus in the amount of $1,204,211.78 and credited other reserves—reserve for charges connected with refinancing of first mortgage bonds, 3.75% series due 1964, and 5.10% cumulative preferred stock. Among other accounts, the book records of New York State, as of December 31, 1946, disclosed accounts of other reserves in the amount of $3,817,410.36, capital surplus $24,840,169.12, and zero for earned surplus. During the year 1947, New York State reduced capital surplus $10,870,667.49 by writing down

Utility Plant to original cost pursuant to orders of the Public Service Commissioner Case No. 8527.

14. On or about March 13, 1947, New York State redeemed said 120,000 shares of its 5.10% cumulative preferred stock of the par value of $100 and paid to its stockholders therefor the redemption price of $105 per share plus accrued dividends from March 1, 1947 to the date of redemption, or an aggregate of $12,620,400. Annexed hereto as Exhibits G-1 and G-2 are copies of the exchange of letters, dated February 11, 1947, between New York State and The Continental Bank & Trust Company of New York acknowledging the deposit on such date by New York State of $12,620,400 with The Continental Bank to be used in the redemption of the aforesaid preferred stock, and $153,000 on account of the quarterly dividend payable March 1, 1947 to holders of said stock. Annexed hereto as Exhibit H is a copy of the amendments to New York State's Certificate of Incorporation filed on February 11, 1947, reflecting the proposed redemption and retirement of such preferred stock.

15. During the year 1947, New York State had net taxable income of $5,172,048.82. Annexed hereto as Exhibit I is the portion of the aforesaid Report of the Revenue Agent, dated March 30, 1953, relating to the net taxable income of New York State for the calendar year 1947.

16. During the year 1947, New York distributed in dividends on all its stocks, exclusive of the $20,400 paid for the period March 1, 1947 to March 13, 1947 in connection with the redemption of the aforesaid 5.10% cumulative preferred stock, the amount of $3,210,009.30.

17. At the end of the calendar year 1947, New York State had earnings and profits, after taking into account all items affecting earnings and profits for such year other than the redemption of its 5.10% cumulative preferred stock, of not less than $1,000,000.

Appendix C

18. New York State paid to its stockholders in redeeming its aforesaid 5.10% cumulative preferred stock an amount which exceeded by $539,192.07 the amount New York State had received on the issuance of such stock, after deducting $41,192.07 of issuance expenses for which no deduction from income had theretofore been claimed or allowed in determining New York State's liability for Federal income tax.

19. At all times here relevant, New York State was a "public utility" and its 5.10% cumulative preferred stock was a "preferred stock" within the meaning of those terms in Section 26(h) of the Internal Revenue Code of 1939, as amended.

20. In connection with the issuance and sale of its 5.10% cumulative preferred stock, New York State's book entries credited capital stock account $12,000,000, credited premiums on capital stock $102,000, and charged capital stock expense account $47,753.99. In connection with the redemption of said preferred stock, New York State charged capital stock account $12,000,000, charged premiums on capital stock $102,000 and credited capital stock expense account $47,753.99, and charged reserve for charges connected with refinancing account $600,000 on account of the aforesaid issuance, sales expenses and the payment of the redemption premium on said preferred stock. Annexed hereto as Exhibit J are copies of 6 New York State Journal Entries reflecting the above credits and charges.

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